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EU AND US HELD WTO CONSULTATIONS ON FSC EXPORT SUBSIDIES

On December 17, 1997, the European Commission and the US held consultations under the World Trade Organization (WTO) with regard to US export subsidies via so-called "Foreign Sales Corporations" (FSCs) in Geneva. Last month, the European Commission requested such consultations in order to put an end to the US policy of granting tax exemptions for exports carried out by FSCs.

Export subsidies - which favor exports compared with the treatment of like products when sold for domestic consumption - are prohibited under the WTO Agreement on Subsidies and Countervailing Measures.

For 1992, the most recent data available, FSCs generated a total turnover of \$152 billion and a gross profit of \$9.6 billion exempt from regular US income taxation. These tax subsidies of US exports of goods and services, which according to some estimates cost the US tax payer \$2 billion per year, have been continuously extended during the last decade. In September 1997 the FSC benefits were extended to the US software industry, which will save approximately \$600 million in taxes over the next five years.

The increasing scope of the FSC is a major concern for the EU. As Sir Leon Brittan, Vice President of the European Commission, commented: *"It is particularly worrying that the FSC scheme subsidises US exports across the board, covering the entire manufacturing industry, computer software and even agricultural products. As a result, it leads to a significant distortion of international trade and inflicts considerable cost on European companies."*

FSCs are usually subsidiaries of US corporations located in tax havens such as the Virgin Islands. These subsidies are only available if a large part of the exported item has been manufactured in the US. They are therefore in the EU's view a clear violation of WTO subsidy rules. The Commission's request for consultations is the first step in the WTO dispute settlement procedure, which, if both sides cannot find a mutually satisfactory solution, could lead to a WTO panel.

The US operates a system of worldwide taxation of the income of its corporations. A foreign tax credit is granted for income taxes paid abroad. In the case of FSCs, which are foreign subsidiaries created to promote the export of their parent US company's products and services, 64 percent of the foreign trade income is exempt from US income tax. In addition, distributions made by FSCs to parent corporations are not subject to any US taxation at all. Such tax exemptions cannot be justified for FSCs, which are typically established in tax havens where no income tax is paid at all. In 1992, 66 percent of all FSCs were incorporated in the US Virgin Islands,

12 percent in Barbados and 7 percent in Guam. It is telling that nothing in the FSC legislation depends on the payment of foreign taxes by the FSC or its parent company.

Classified by the total turnover of FSCs, the largest exported manufactured product groups benefiting from this system are non-electrical machinery (\$29.8 billion), chemicals (\$29.3 billion), electrical machinery (\$21.1 billion) and transportation equipment (\$18.1 billion). The largest non-manufactured product or service group is grains and soybeans (\$4.4 billion).

Prior to the FSC, the US operated a similar system of tax deferrals on export earnings, called "Domestic International Sales Corporations" (DISC's). The DISC system was subject to a dispute settlement procedure brought by the EU in the GATT. The GATT panel report presented in 1976 found that this scheme operated as an export subsidy and should be abolished. While subsequently some technical aspects were altered to bring the system formally in line with GATT/WTO rules, the basic economic purpose of the system has not been changed. As was the case for its predecessor, the only rationale for the FSC is the promotion of US exports.

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